# OPEN MEETING

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ORIGINAL

## MEMORANDUM

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Arizona Corporation Commission
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NOV - 4 2009

AZ CORP COMMISSION
DOCKET CONTROL

DOCKETED BY

TO: THE COMMISSION

FROM: Utilities Division

DATE: November 4, 2009

RE: SOUTHWEST GAS CORPORATION – APPLICATION FOR APPROVAL OF A TEMPORARY CUSTOMER CREDIT TO THE GAS COST BALANCING ACCOUNT (DOCKET NO. G-01551A-09-0490)

*Background*

On October 14, 2009, Southwest Gas Corporation ("Southwest" or "the Company) filed an application for approval of a temporary customer credit adjustment, or surcredit, of $0.07678 per therm until the bank balance reaches zero, or until further Commission action.

Southwest is currently over-collected by approximately $38 million. Although currently under the Company's $55.78 million threshold, the over-collected bank balance is projected to increase, and Southwest believes that it is reasonable to implement a surcredit at this time. Staff concurs and estimates that, in the absence of a surcredit, the bank balance would exceed the threshold by April 2010 and remain highly over-collected into 2011.

Southwest proposes to implement the surcredit as of December 2009, so that its customers will benefit from the surcredit during the upcoming winter months. Average residential therm usage is highest from December through March.

Southwest provides service in the counties of Cochise, Gila, Graham, Greenlee, La Paz, Maricopa, Mohave, Pima, Pinal and Yuma. Currently, the Company has approximately 980,000 customers in Arizona. (Southwest also provides service in California and Nevada.)

*The PGA Mechanism*

Like other gas utilities, while Southwest is not allowed to make a profit on the cost of the natural gas it provides, it is permitted to recover the cost of that gas. The Company recovers the cost of the gas, including its transportation costs, through a Purchased Gas Adjustor ("PGA") rate.

Currently, the Southwest PGA rate is calculated based on a twelve-month rolling average, with a $0.15 per therm annual bandwidth. The cost of natural gas can change dramatically over a short period of time, increasing the risk of rate shocks to customers. The PGA mechanism is designed to limit these shocks and reduce the volatility of gas costs passed on to customers. The rolling average produces a more predictable and consistent PGA rate, while the bandwidth provides another brake on volatility by limiting changes (increases or decreases) to no more than $0.15 per therm over a year's time.

Differences between the rolling average cost of gas and the actual cost of natural gas are tracked and recorded in the PGA bank balance, so that under-collections can be recovered by the Company and over-collections can be returned to ratepayers. A threshold for over-collection ensures that over-collections will be returned to ratepayers once this upper limit is reached.

Interest is paid on the PGA bank balance based on the monthly one-year nominal Treasury constant maturities rate. The current monthly rate is applied against the beginning balance each month, then the interest is credited to the balance.

Decision No. 70665 (December 24, 2008) set the threshold for over-collection at $55.78 million and ordered that the threshold for under-collection be eliminated. (With no threshold for under-collection, Southwest can choose to forgo a surcharge in instances where changing market conditions would make a surcharge unnecessary. )

*Surcredit Options*

Staff's analysis indicates that a surcredit is required to pay down the approximately $38 million Southwest over-collection and would be in the public interest. In order to set an appropriate surcredit level, the advantages of paying down the over-collection in a timely fashion should be weighed against the possibility of contributing to later under-collections that could be burdensome to resolve. (When the Company is under-recovering for its cost of natural gas, a surcredit can increase an under-collected bank balance, making it more likely that a surcharge, or additional per-therm charge, would become necessary.)

Several scenarios are discussed below, based on current projections regarding the cost of natural gas. Natural gas prices are highly volatile and actual prices may vary significantly from projections, impacting the PGA bank balance.

*Scenario 1*. Southwest proposed a surcredit of $0.07678. Based on this level of surcredit, projections indicate that the Company will be over-collected by more than $24 million at the end of December 2010, but that the balance is projected to reach zero in April 2011. This level of surcredit pays down the current $38 million over-collection, but does not address the over-collection that is likely to occur going forward.

Under Scenario 1, customer bills would be reduced by an estimated average of $2.98 during the five highest usage (winter) months and an average of $0.78 during the five lowest usage (summer) months.

*Scenario 2*. A flat surcredit of $0.08000 would result in an over-collected balance of $22,448,405 at the end of December 2010, with the balance reaching zero in March 2011. This level of surcredit would pay down the existing over-collection, address the continuing over-collections and limit the risk of the surcredit contributing to a large under-collection in the event of future increases in the price of natural gas.

Under Scenario 2, customer bills would be reduced by an estimated average of $3.10 during the five highest usage (winter) months and an average of $0.82 during the five lowest usage (summer) months.

*Scenario 3*. A flat surcredit of $0.08500 would result in an over-collected balance of $19,666,243 at the end of 12 months, with the balance moving from over-collection to a $3,185,927 under-collection in March 2011. This level of surcredit would pay down the existing over-collection and address continuing over-collections. It would also be more sensitive to increases in the price of natural gas and more likely, in that event, to contribute to a future under-collection.

Under Scenario 3, customer bills would be reduced by an estimated average of $3.30 during the five highest usage (winter) months and an average of $0.87 during the five lowest usage (summer) months.

*Scenario 4*. This graduated surcredit would begin at $0.10, then decline by stages to $0.04000. The $0.04000 would remain in place until the surcredit terminated. This graduated surcredit would result in an over-collected balance of $22,285,432 at the end of December 2010. Under this scenario, the balance would drop below $10 million in 2011, but would not reach zero.

Under Scenario 4, customer bills would be reduced by an estimated average of $3.66 during the five highest usage (winter) months and an average of $0.53 during the five lowest usage (summer) months.

*Scenario 5*. Scenario 5 is another graduated surcredit, beginning in the winter with three months of a $0.12 per therm credit, then declining by a cent each month until December 2010, when the surcredit would be $0.03 per therm and would terminate as the bank balance reached zero. Under this scenario, the Company is projected to become under-collected $5.7 million by December 2010. In this scenario, significant under-collection could result during 2011.

Under Scenario 5, customer bills would be reduced by an estimated average of $4.50 during the five highest usage (winter) months and an average of $0.62 during the five lowest usage (summer) months.

Staff recommends that a surcredit of $0.08000 per therm (Scenario 2) be implemented beginning December 2009 and continue until the bank balance reaches zero or until further Commission action, whichever occurs first. The $0.08000 per therm surcredit provides a reasonable balance between the need to pay down the over-collection in a timely fashion and the risk of a surcredit contributing to a burdensome future under-collection.

Steven M. Olea
Director
Utilities Division

SMO:JMK:lhm\RM

ORIGINATOR: Julie McNeely-Kirwan

**BEFORE THE ARIZONA CORPORATION COMMISSION**

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
Commissioner
BOB STUMP
Commissioner

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|---|---|
| IN THE MATTER OF THE APPLICATION OF SOUTHWEST GAS CORPORATION FOR APPROVAL OF A TEMPORARY CUSTOMER CREDIT TO THE GAS COST BALANCING ACCOUNT | DOCKET NO. G-01551A-09-0490<br>DECISION NO. __________<br><u>ORDER</u> |

Open Meeting
November 19 and 20, 2009
Phoenix, Arizona

BY THE COMMISSION:

<u>FINDINGS OF FACT</u>

*<u>Background</u>*

1. Southwest Gas Corporation. ("Southwest" or "the Company") is engaged in providing natural gas within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission.

2. On October 14, 2009, Southwest filed an application for approval of a temporary customer credit adjustment, or surcredit, of $0.07678 per therm until the bank balance reaches zero, or until further Commission action.

3. Southwest is currently over-collected by approximately $38 million. Although currently under the Company's $55.78 million threshold, the over-collected bank balance is projected to increase, and Southwest believes that it is reasonable to implement a surcredit at this time. Staff concurs and estimates that, in the absence of a surcredit, the bank balance would exceed the threshold by April 2010 and remain highly over-collected into 2011.

4. Southwest proposes to implement the surcredit as of December 2009, so that its customers will benefit from the surcredit during the upcoming winter months. Average residential therm usage is highest from December through March.

5. Southwest provides service in the counties of Cochise, Gila, Graham, Greenlee, La Paz, Maricopa, Mohave, Pima, Pinal and Yuma. Currently, the Company has approximately 980,000 customers in Arizona. (Southwest also provides service in California and Nevada.)

*The PGA Mechanism*

6. Like other gas utilities, while Southwest is not allowed to make a profit on the cost of the natural gas it provides, it is permitted to recover the cost of that gas. The Company recovers the cost of the gas, including its transportation costs, through a Purchased Gas Adjustor ("PGA") rate.

7. Currently, the Southwest PGA rate is calculated based on a twelve-month rolling average, with a $0.15 per therm annual bandwidth. The cost of natural gas can change dramatically over a short period of time, increasing the risk of rate shocks to customers. The PGA mechanism is designed to limit these shocks and reduce the volatility of gas costs passed on to customers. The rolling average produces a more predictable and consistent PGA rate, while the bandwidth provides another brake on volatility by limiting changes (increases or decreases) to no more than $0.15 per therm over a year's time.

8. Differences between the rolling average cost of gas and the actual cost of natural gas are tracked and recorded in the PGA bank balance, so that under-collections can be recovered by the Company and over-collections can be returned to ratepayers. A threshold for over-collection ensures that over-collections will be returned to ratepayers once this upper limit is reached.

9. Interest is paid on the PGA bank balance based on the monthly one-year nominal Treasury constant maturities rate. The current monthly rate is applied against the beginning balance each month, then the interest is credited to the balance.

10. Decision No. 70665 (December 24, 2008) set the threshold for over-collection at $55.78 million and ordered that the threshold for under-collection be eliminated. (With no

threshold for under-collection, Southwest can choose to forgo a surcharge in instances where changing market conditions would make a surcharge unnecessary. )

*Surcredit Options*

11. Staff's analysis indicates that a surcredit is required to pay down the approximately $38 million Southwest over-collection and would be in the public interest. In order to set an appropriate surcredit level, the advantages of paying down the over-collection in a timely fashion should be weighed against the possibility of contributing to later under-collections that could be burdensome to resolve. (When the Company is under-recovering for its cost of natural gas, a surcredit can increase an under-collected bank balance, making it more likely that a surcharge, or additional per-therm charge, would become necessary.)

12. Several scenarios are discussed below, based on current projections regarding the cost of natural gas. Natural gas prices are highly volatile and actual prices may vary significantly from projections, impacting the PGA bank balance.

13. *Scenario 1.* Southwest proposed a surcredit of $0.07678. Based on this level of surcredit, projections indicate that the Company will be over-collected by more than $24 million at the end of December 2010, but that the balance is projected to reach zero in April 2011. This level of surcredit pays down the current $38 million over-collection, but does not address the over-collection that is likely to occur going forward.

14. Under Scenario 1, customer bills would be reduced by an estimated average of $2.98 during the five highest usage (winter) months and an average of $0.78 during the five lowest usage (summer) months.

15. *Scenario 2.* A flat surcredit of $0.08000 would result in an over-collected balance of $22,448,405 at the end of December 2010, with the balance reaching zero in March 2011. This level of surcredit would pay down the existing over-collection, address the continuing over-collections and limit the risk of the surcredit contributing to a large under-collection in the event of future increases in the price of natural gas.

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. . .

16. Under Scenario 2, customer bills would be reduced by an estimated average of $3.10 during the five highest usage (winter) months and an average of $0.82 during the five lowest usage (summer) months.

17. *Scenario 3*. A flat surcredit of $0.08500 would result in an over-collected balance of $19,666,243 at the end of 12 months, with the balance moving from over-collection to a $3,185,927 under-collection in March 2011. This level of surcredit would pay down the existing over-collection and address continuing over-collections. It would also be more sensitive to increases in the price of natural gas and more likely, in that event, to contribute to a future under-collection.

18. Under Scenario 3, customer bills would be reduced by an estimated average of $3.30 during the five highest usage (winter) months and an average of $0.87 during the five lowest usage (summer) months.

19. *Scenario 4*. This graduated surcredit would begin at $0.10, then declines by stages to $0.04000. The $0.04000 would remain in place until the surcredit terminated. This graduated surcredit would result in an over-collected balance of $22,285,432 at the end of December 2010. Under this scenario, the balance would drop below $10 million in 2011, but would not reach zero.

20. Under Scenario 4, customer bills would be reduced by an estimated average of $3.66 during the five highest usage (winter) months and an average of $0.53 during the five lowest usage (summer) months.

21. *Scenario 5*. Scenario 5 is another graduated surcredit, beginning in the winter with three months of a $0.12 per therm credit, then declining by a cent each month until December 2010, when the surcredit would be $0.03 per therm and would terminate as the bank balance reached zero. Under this scenario, the Company is projected to become under-collected $5.7 million by December 2010. In this scenario, significant under-collection could result during 2011.

22. Under Scenario 5, customer bills would be reduced by an estimated average of $4.50 during the five highest usage (winter) months and an average of $0.62 during the five lowest usage (summer) months.

. . .

23. Staff has recommended that a surcredit of $0.08000 per therm (Scenario 2) be implemented beginning December 2009 and continue until the bank balance reaches zero or until further Commission action, whichever is first. The $0.08000 per therm surcredit provides a reasonable balance between the need to pay down the over-collection in a timely fashion and the risk of a surcredit contributing to a burdensome future under-collection.

## CONCLUSIONS OF LAW

1. Southwest is an Arizona public service corporation within the meaning of Article XV, Section 2, of the Arizona Constitution.

2. The Commission has jurisdiction over Southwest and over the subject matter of the application.

3. The Commission, having reviewed the application and Staff's Memorandum dated November 4, 2009, concludes that it is in the public interest to approve a temporary customer credit (or surcredit), as discussed herein.

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ORDER

IT IS THEREFORE ORDERED that a $0.08000 per-therm surcredit be established beginning December 1, 2009, and shall continue until the Southwest purchased gas adjustor bank balance reaches zero or until further Commission action, whichever occurs first.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

**BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

CHAIRMAN COMMISSIONER

COMMISSIONER COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this _______day of ___________________ , 2009.

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DISSENT: ____________________________

DISSENT: ____________________________

SMO:JMK:lhm\RM

SERVICE LIST FOR: Southwest Gas Corporation
DOCKET NO. G-01551A-09-0490

Mr. Justin Lee Brown, Esq.
Assistant General Counsel
Southwest Gas Corporation
Post Office Box 985210
Las Vegas, Nevada 89193-8510

Mr. Edward Geiseking
Director/Pricing & Tariffs
Southwest Gas Corporation
Post Office Box 985210
Las Vegas, Nevada 89193-8510

Mr. Steven M. Olea
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Ms. Janice M. Alward
Chief Counsel, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

**EXHIBIT 1**

**Projected Purchased Gas Adjustor Credit Per Therm Each Month**

| | Dec-09 | Jan-10 | Feb-10 | Mar-10 | Apr-10 | May-10 | Jun-10 | Jul-10 | Aug-10 | Sep-10 | Oct-10 | Nov-10 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 0 surcredit | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 |
| Scenario 1 | $0.07678 | $0.07678 | $0.07678 | $0.07678 | $0.07678 | $0.07678 | $0.07678 | $0.07678 | $0.07678 | $0.07678 | $0.07678 | $0.07678 |
| Scenario 2 | $0.08000 | $0.08000 | $0.08000 | $0.08000 | $0.08000 | $0.08000 | $0.08000 | $0.08000 | $0.08000 | $0.08000 | $0.08000 | $0.08000 |
| Scenario 3 | $0.08500 | $0.08500 | $0.08500 | $0.08500 | $0.08500 | $0.08500 | $0.08500 | $0.08500 | $0.08500 | $0.08500 | $0.08500 | $0.08500 |
| Scenario 4 | $0.10000 | $0.10000 | $0.10000 | $0.08000 | $0.08000 | $0.08000 | $0.06000 | $0.06000 | $0.06000 | $0.04000 | $0.04000 | $0.04000 |
| Scenario 5 | $0.12000 | $0.12000 | $0.12000 | $0.11000 | $0.10000 | $0.09000 | $0.08000 | $0.07000 | $0.06000 | $0.05000 | $0.04000 | $0.03000 |

**Projected Purchased Gas Adjustor Bank Balance at the End of Each Month**

| | Dec-09 | Jan-10 | Feb-10 | Mar-10 | Apr-10 | May-10 | Jun-10 | Jul-10 | Aug-10 | Sep-10 | Oct-10 | Nov-10 | Dec-10 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 0 surcredit | (35,166,197) | (35,708,660) | (47,910,931) | (55,313,068) | (59,607,963) | (67,926,735) | (71,413,189) | (73,762,331) | (74,754,851) | (74,257,549) | (73,587,882) | (76,041,711) | (66,963,000) |
| Scenario 1 | (35,166,197) | (29,756,329) | (34,780,119) | (35,892,937) | (35,183,887) | (40,088,456) | (41,056,125) | (41,255,417) | (40,383,648) | (38,157,388) | (35,650,314) | (36,072,888) | (24,240,117) |
| Scenario 2 | (35,166,197) | (29,506,700) | (34,229,439) | (35,078,496) | (34,159,590) | (38,920,975) | (39,783,011) | (39,892,143) | (38,942,188) | (36,643,419) | (34,059,288) | (34,396,675) | (22,448,405) |
| Scenario 3 | (35,166,197) | (29,119,078) | (33,374,346) | (33,813,836) | (32,569,068) | (37,108,115) | (37,806,125) | (37,775,256) | (36,703,897) | (34,292,537) | (31,588,751) | (31,793,861) | (19,666,243) |
| Scenario 4 | (35,166,197) | (27,956,210) | (30,809,065) | (30,019,853) | (29,098,839) | (33,858,115) | (34,718,042) | (35,381,771) | (34,912,028) | (33,058,216) | (31,421,987) | (32,808,261) | (22,285,432) |
| Scenario 5 | (35,166,197) | (26,405,721) | (27,388,693) | (24,961,212) | (22,086,076) | (25,955,734) | (26,485,826) | (26,589,417) | (25,874,966) | (24,017,389) | (22,140,043) | (14,072,576) | 5,727,733 |

Note 1: Numbers in parentheses denote over-collected PGA bank balances; numbers not in parentheses represent under-collected bank balances.

Note 2: The impact of a surcredit instituted in December would not show up until the following January. An extra month is added to show 12 months of impact from the surcredit.

**Projected Bill Impacts (decreases)**

| | Dec-09 | Jan-10 | Feb-10 | Mar-10 | Apr-10 | May-10 | Jun-10 | Jul-10 | Aug-10 | Sep-10 | Oct-10 | Nov-10 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Res. Usage | 33 | 62 | 45 | 32 | 22 | 15 | 12 | 10 | 9 | 9 | 11 | 16 |
| 0 surcredit | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 |
| Scenario 1 | $2.53 | $4.76 | $3.46 | $2.46 | $1.69 | $1.15 | $0.92 | $0.77 | $0.69 | $0.69 | $0.84 | $1.23 |
| Scenario 2 | $2.64 | $4.96 | $3.60 | $2.56 | $1.76 | $1.20 | $0.96 | $0.80 | $0.72 | $0.72 | $0.88 | $1.28 |
| Scenario 3 | $2.81 | $5.27 | $3.83 | $2.72 | $1.87 | $1.28 | $1.02 | $0.85 | $0.77 | $0.77 | $0.94 | $1.36 |
| Scenario 4 | $3.30 | $6.20 | $4.50 | $2.56 | $1.76 | $1.20 | $0.72 | $0.60 | $0.54 | $0.36 | $0.44 | $0.64 |
| Scenario 5 | $3.96 | $7.44 | $5.40 | $3.52 | $2.20 | $1.35 | $0.96 | $0.70 | $0.54 | $0.45 | $0.44 | $0.48 |

**Projected Bill Impacts (totals, monthly, delivery charge and PGA rate)**

| | Dec-09 | Jan-10 | Feb-10 | Mar-10 | Apr-10 | May-10 | Jun-10 | Jul-10 | Aug-10 | Sep-10 | Oct-10 | Nov-10 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 0 surcredit | 47.92 | 111.44 | 70.60 | 45.25 | 30.75 | 22.70 | 19.74 | 17.90 | 17.05 | 17.05 | 18.79 | 23.65 |
| Scenario 1 | 45.39 | 106.67 | 67.15 | 42.80 | 29.06 | 21.55 | 18.82 | 17.13 | 16.36 | 16.36 | 17.94 | 22.43 |
| Scenario 2 | 45.28 | 106.48 | 67.00 | 42.69 | 28.99 | 21.50 | 18.78 | 17.10 | 16.33 | 16.33 | 17.91 | 22.37 |
| Scenario 3 | 45.12 | 106.17 | 66.78 | 42.53 | 28.88 | 21.42 | 18.72 | 17.05 | 16.28 | 16.28 | 17.85 | 22.29 |
| Scenario 4 | 44.62 | 105.24 | 66.10 | 42.69 | 28.99 | 21.50 | 19.02 | 17.30 | 16.51 | 16.69 | 18.35 | 23.01 |
| Scenario 5 | 43.96 | 104.00 | 65.20 | 41.73 | 28.55 | 21.35 | 18.78 | 17.20 | 16.51 | 16.60 | 18.35 | 23.17 |

| | winter average |
|---|---|
| Scenario 1 | $2.98 |
| Scenario 2 | $3.10 |
| Scenario 3 | $3.30 |
| Scenario 4 | $3.66 |
| Scenario 5 | $4.50 |

| | summer average |
|---|---|
| Scenario 1 | $0.78 |
| Scenario 2 | $0.82 |
| Scenario 3 | $0.87 |
| Scenario 4 | $0.53 |
| Scenario 5 | $0.62 |